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Financial Markets

Irving Trust

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Economic Research &
Planning Division

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Friday Feb. 15, 1980

In a busy finale to a nervous week, events on Friday morning compounded confusion and left participants wondering which way to look next. First, the Labor Department announced a 1.6% jump in January producer prices for finished goods, much more than most market watchers had expected. Then, the Federal Reserve announced a 1% discount rate hike to an all-time record of 13%. Finally, the Federal funds rate edged up after the discount rate hike. The absence of Fed response to this, some would argue, may be a sign of Fed tightening.

All this did nothing to calm the market's jangled nerves, and prices continued the downtrend that began on Monday. Prices of two-year Treasury notes hit all-time lows on Thursday and fell further after Friday's news, while the one-year bill hit new lows on Friday. Declines in longer-term securities were less dramatic, but the market retreat went across the board.

This week's decline continued a trend that has been in process since the start of the year, and reflects the wrenching U-turn that is taking place in many observers' assessments of the economic outlook. Recessionary expectations are giving way to inflation fears (a process that may be compounded by the feeling that even if a recession does come it may not do much about inflation), and investors are more and more averse to long-term fixed income investments.

Recent January economic data confirmed the market's worst fears in this direction. Even before the inflation number was reported, announcement of a 2.3% jump in January retail sales was unsettling; even allowing for seasonal adjustment problems and mild weather, this points to more economic strength than had been expected. As to the producer price data, the January jump was twice the 0.6%-0.8% most observers had expected and was the sharpest increase since November 1974. Energy price hikes were a major factor, but other prices are moving up too--consumer durables prices, for example, rose 3.2% in January.

Reaction to Friday's news was a measure of the persistent pessimism of the market's underlying mood. Inflation news was unequivocally negative, but the discount rate hike could have been taken either way. Markets focused on the dim side. Instead of interpreting the Fed's action as an appropriate reaction to inflationary pressures and bidding up prices for longer-term issues, the immediate response concentrated on the negative impact of higher short-term rates on cost of carry.

Why? The dust is far from settled, and it is too early to form a fixed conclusion, but some market watchers argue that the discount rate hike (and the subsequent edging up in Federal funds) may yet be followed by further tightening moves. With no clear idea as to how far the Fed may go (if indeed a policy shift is in process) investors may prefer to adopt a wait-and-see policy. Near-term prospects are very uncertain, but this week's events emphasize once again that interpreting policy actions has become a more difficult job since the Fed de-emphasized the Federal funds rate as a target of credit policy.

Anne Parker Mills

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Money Market Rates

	2/15/80 (noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company			
Short-term loans to substantial depositors with highest credit rating	15.25%	15.25%	11.75%
Effective since	12/7/79		
Discount Rate at Federal Reserve Bank	13.00	12.00	9.50
Federal Funds	14.75	13.00	10.12
Repurchase Agreements	12.50	11.75	9.60
U.S. Treasury Issues - Yields			
Bills			
3 months	13.63	12.30	9.60
6 months	14.15	12.84	9.95
1 year	13.82	12.63	10.18
Coupons			
2 years	13.10	12.00	9.67
4 years	12.25	11.40	9.15
7 years	12.20	11.60	9.11
10 years	12.15	11.55	9.12
Long Bond	12.10	11.60	9.02
Negotiable Certificates of Deposit-Secondary Market			
1 month	13.75	13.25	9.90
3 months	14.00	13.40	10.25
6 months	14.45	13.70	10.65
1 year	13.75	13.40	10.85
Bankers' Acceptances			
1 month	13.60	13.15	9.90
3 months	14.00	13.43	10.00
6 months	14.50	13.73	10.10
Eurodollar Deposits			
1 month	14.75	13.81	10.50
2 months	14.88	14.19	10.69
3 months	15.13	14.38	10.88
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	12.75	8.00	9.50
1 month	13.00	13.00	9.75
3 months	12.25	12.25	9.63
Bank Holding Companies			
1 month	13.13	13.13	9.70
Dealer Placed:			
3 months	13.38	13.05	10.05
New Aa Corporate Utility Bond	13.75	13.10	9.65
Tax Exempt			
6 month Project Notes	6.25	5.50	5.10
12 month Project Notes	N/A	N/A	5.30
20 year AAA Bond	7.50	7.00	5.75

This information represents prevailing market yields. It should not be construed as an offering. All yields are on the offered side of the market.

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